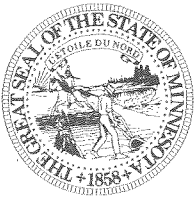


**DEPARTMENT OF ADMINISTRATION
SPECIAL REVIEW
CAPITOL COMPLEX CAFETERIAS CONTRACT
NOVEMBER 1980 - JUNE 1986**

JULY 1986



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

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Senator Randolph W. Peterson, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

Sandra Hale, Commissioner
Department of Administration

Mr. William Benzick, President
Best, Inc.

Audit Scope

We have completed a special review of the state contract with Best, Inc. for the operation of the five Capitol Complex cafeterias. This contract was administered by the Plant Management Division of the Department of Administration. The contract was effective for the period from November 1, 1980 through June 30, 1986. Section I - INTRODUCTION provides a brief description on the contract terms and provisions. Our review was initiated through a request from the Director of Plant Management. Information concerning our initial involvement in the review are highlighted in Section II - BACKGROUND INFORMATION.

Our review was made in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the U.S. General Accounting Office Standards for Audit of Government Organizations, Programs, Activities, and Functions, and accordingly, included such audit procedures as we considered necessary in the circumstances, except as discussed in the Scope Limitations section of this letter. Our review was completed on May 30, 1986.

The objectives of our review were to:

- determine the ownership of equipment used in the Capitol Complex cafeterias, and;
- determine whether the state has received all commissions due to them under the terms of the contract.

Scope Limitations

We could not verify the cafeteria equipment inventory as of November 1, 1980. We were unable to determine whether any agreement between Best, Inc. and the state was reached as to the equipment to be transferred to the control of Best, Inc. at the start of the contract between Best, Inc. and the state. This is important because, according to the cafeteria contract, equipment ownership is dependent on the equipment on hand when the contract began. In addition, Plant Management did not maintain adequate records to support equipment purchases and disposals during the contract period, either made by Best, Inc. or by the state. We therefore found the equipment inventory to be unauditable.

Senator Randolph Peterson, Chairman
Members of the Legislative Audit Commission
Sandra Hale, Commissioner
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Page 2

Our review of commission amounts was limited to a review of financial information provided to Plant Management by Best, Inc. These included monthly operating statements and location commission reconciliation statements. We did not audit the revenues or expenses reported by Best, Inc. relating to the Capitol Complex cafeterias.

Audit Techniques

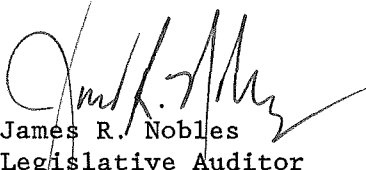
We employed a variety of audit techniques during our review. We analyzed the terms of the contract between the state and Best, Inc. We obtained and reviewed correspondence files from Plant Management relating to the cafeteria contract, including monthly operating statements and location commission reconciliation statements sent to Plant Management by Best, Inc. during the course of the contract. We conducted extensive interviews with the Department of Administration Plant Management Division and Fiscal Services staff, Administration's Special Assistant Attorney General, the food service consultant hired by Plant Management, and Best, Inc. employees. We also obtained and reviewed invoices from Best, Inc. supporting disbursements made by Best, Inc. from state location commission funds. We obtained and reviewed available equipment lists provided by Plant Management. We performed other additional procedures we deemed necessary under the circumstances.

Conclusions

Because of the lack of information available relating to cafeteria equipment, as discussed in the Scope Limitations section of this letter, we were unable to determine the ownership of the Capitol Complex cafeteria equipment and we therefore do not express an opinion on the ownership of this equipment. Equipment relating to the cafeteria contract is discussed in more detail in Section III - EQUIPMENT of this report.

In our opinion, relying on the financial information obtained from Best, Inc. which was not audited, as discussed in the Scope Limitations section of this letter, commission amounts as presented in Table 5, page 16 accurately represent the results of the contract with Best, Inc. We were unable to determine whether disbursements made by Best, Inc. from location commissions on behalf of the state were legal. Section IV - COMMISSIONS provides additional information concerning commissions earned and spent over the contract period.

Section V - CONCLUSIONS provides our overall conclusions and other observations relating to the contract between Best, Inc. and the state. We believe that control and monitoring of the cafeteria contract must be improved in order for the new cafeteria contract to be successful.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

July 16, 1986

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION	1
II. BACKGROUND INFORMATION	2
III. EQUIPMENT	3
IV. COMMISSIONS	7
V. CONCLUSIONS	18
AGENCY RESPONSE	21
BEST, INC. RESPONSE	27

AUDIT PARTICIPATION

The following members of the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA	Audit Manager
Michael Hassing	Auditor-in-Charge

EXIT CONFERENCES

This report was discussed with the following Department of Administration staff at an exit conference which we held with them on June 23, 1986:

Jim Pederson, Assistant Commissioner
James Ware, Director of Plant Management
Roger Hostager, Plant Management Analyst
Dick Diercks, Administrative Services Bureau Manager
Don Klein, Manager of Fiscal Services

This report was also discussed with Perry Rynders, the Vice President for Finance of Best, Inc. on June 25, 1986.

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

I. INTRODUCTION

In October 1980, the State of Minnesota contracted with Best, Inc. to provide cafeteria food service in the Capitol, Capitol Square, Centennial, State Office, and Transportation Buildings in St. Paul. The contract was originally effective from November 1, 1980 to November 1, 1985. It was later extended through June 30, 1986.

In exchange for the exclusive right to operate these cafeterias, Best, Inc. agreed to pay a 1.5 percent location commission to the state, based on gross operating revenue. In addition, all excess profits, as defined in the contract, were to be paid to the state. Best, Inc. was allowed a combined net profit and administrative expense of not to exceed 5 percent of gross cafeteria revenue annually.

The state provided certain cafeteria equipment for Best, Inc. when the contract began. Best, Inc. was required to provide all dishes, silverware, pots, pans, equipment, and all other necessary items not provided by the state.

The Plant Management Division of the Department of Administration served as the state's representative for the contract. All correspondence from Best, Inc. concerning the contract was handled through Plant Management.

The Capitol Complex cafeteria contract was rebid in 1986 for a contract period to begin on July 1, 1986. Best, Inc. was not the successful bidder for this new contract.

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

II. BACKGROUND INFORMATION

In order to prepare bid specifications for a new Capitol Complex cafeteria contract, the Plant Management Division hired a consultant knowledgeable in food service operations. In the course of his work, the consultant raised several issues concerning the cafeteria contract between Best, Inc. and the state. Plant Management also had some questions and concerns about the contract. Therefore, on April 14, 1986, we received a memo from James Ware, Director of the Plant Management Division, requesting an audit of the five Capitol Complex cafeterias.

In response to this request, we performed a preliminary review of the administration of the Best, Inc. contract and the unresolved issues relating to it. As a result of this preliminary work, we identified two major objectives. They were to:

- determine the ownership of equipment used in the Capitol Complex cafeterias, and;
- determine whether the state has received all commissions due to them under the terms of the contract.

We did not perform a complete financial and compliance audit of the Best, Inc. contract or of the Capitol Complex cafeterias. Rather, we focused our attention to those issues currently in dispute between Best, Inc. and the state, as well as a review of the overall administration and monitoring of the contract by Plant Management. The annual corporate financial statements of Best, Inc. are audited by a private CPA firm.

This report represents the results of our review. The report is divided into three sections, corresponding to the audit objectives listed above and including an overall conclusions section.

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

III. EQUIPMENT OWNERSHIP

We attempted to determine ownership of the equipment used in the Capitol Complex cafeterias. The contract provisions require each party to provide certain items of equipment. However, the contract language concerning equipment ownership is often unclear and difficult to interpret. In addition to the interpretative problems with the contract, equipment inventory records are incomplete and internal controls governing equipment have been ineffective. Another complicating factor is the absence of a direct correlation between who finances an equipment purchase and who retains ownership rights. As a result of these problems, it was impossible to establish ownership for most equipment items.

Contract Provisions Governing Equipment Ownership

The state provided certain equipment to Best, Inc. for use in the cafeterias when the contract began. According to the contract, an agreement of what constituted that equipment was to be determined at the onset. Schedule B, Part 1.D.b. of the contract states:

"The Vendor and the state representative shall compile a complete inventory record of equipment, utensils, and furniture prior to the contract effective date."

We could find no conclusive evidence that such an inventory record was ever made, or that an agreement concerning the equipment on hand at that date was ever reached. We did obtain an equipment list which, Plant Management officials told us, was compiled at the start of the contract between Best, Inc. and the state. However, there is no way to determine whether this list is comprehensive and had the agreement of Plant Management and Best, Inc.

The contract further stipulated that the original equipment provided by the state was to be inspected by both parties. If both parties concurred that an item needed repair or replacement, then an agreement was to be negotiated. This is discussed in Part 2.d. of the contract:

"When the Vendor begins operation of the cafeterias on November 1, 1980 it shall immediately inspect all state owned equipment in the cafeterias and notify the State at once if any such equipment is in a state of disrepair or not in working order. The State shall make its own inspection of the equipment and where the State concurs with the Vendor's findings the State and the Vendor shall negotiate an agreement providing for the repair or replacement of such equipment and the method of payment therefore."

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

We have reviewed correspondence between Best, Inc. and Plant Management concerning equipment problems which existed at the time the contract began. However, we could not determine whether Plant Management ever conducted a comprehensive inspection and negotiation with Best, Inc. for the repair or replacement of this equipment.

The only evidence of any negotiation regarding the condition of the original equipment appears in correspondence from 1981 and 1983 concerning a dishwasher at Capitol Square. The dishwasher was finally replaced in fiscal year 1983 at a cost of \$8,423.16. The replacement was financed with state funds being held by Best, Inc. at the time (see related discussion in Section IV on COMMISSIONS).

The state was to retain ownership of the original equipment, but the vendor was responsible for equipment maintenance and replacement, if necessary. Schedule B, Part 12 of the contract states:

"In the event the Vendor deems it advantageous to replace any of the existing equipment furnished by the State, he may do so after obtaining written approval from the State. The cost of this new or replacement equipment shall be the Vendor's cost and such costs may be included as an operating expense under the terms of the contract; however, such new or replacement equipment shall become the property of the State."

Best, Inc. was required to provide other equipment items pursuant to Schedule B, Part 1.D.a. of the contract:

"It will be the duty of the Vendor to supply all dishes, silverware, pots, pans, equipment, and all other necessary items not provided by the State. The cost of such items to the Vendor may be included as an operating expense under the terms of this contract and the items so purchased will be considered as the property of the Vendor."

Finally, the state could finance and retain ownership of additional equipment items, at its own discretion. The only apparent funding source for any such acquisitions was in the form of location commissions which were owed to the state by Best, Inc., but being held on the state's behalf. The practice of allowing Best, Inc. to hold and spend state funds is discussed more thoroughly in Section IV on COMMISSIONS. As of May 3, 1986, Best, Inc. had spent \$18,626.17 of state funds on additional equipment. Clearly the state retains ownership of these equipment items, because they financed the acquisitions. However, as discussed in Section IV on COMMISSIONS, if the state requires Best, Inc. to repay location commissions used to purchase this equipment, ownership must be redetermined based on the contract clauses cited above.

Based on these contract provisions, we believe that the state retains ownership rights for any equipment items which were:

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

- (1) furnished by the state at the origin of the contract, or
- (2) replacement items for any original equipment furnished by the state, whether financed by the state or Best, Inc., or
- (3) additional items purchased by Best, Inc. on behalf of the state, using location commisssion funds owed to the state.

Conversely, we believe that Best, Inc. retains ownership rights for any equipment items which were in addition to the original equipment inventory and financed with their own funds.

Problems Precluding the Establishment of Equipment Ownership

The contract provided the criteria for establishing equipment ownership. However, several actions contemplated by the contract were never fulfilled, or no evidential support of such actions was maintained. The most critical action lacking was the absence of a beginning inventory of equipment provided by the state. Most ownership issues are premised on whether an item was included in the beginning state equipment inventory. If an item was part of the beginning state equipment inventory, irrespective of whether it was replaced and who may have financed any replacement, the state is entitled to the return of the item or its replacement.

Any items that were added to the beginning state equipment inventory would belong to whomever had financed their acquisition. However, there is not necessarily a correlation between financing an acquisition and ownership. Again, it was dependent upon whether an item was part of the original state equipment inventory. Hence, it is not possible to rely upon purchase documents to establish ownership.

Potentially it would have been possible to reconstruct a beginning state equipment inventory. Unfortunately, equipment records are incomplete during the contract term. We have no way of determining which, if any, equipment was removed or replaced by Plant Management during the contract period. We also have no way of knowing which equipment was replaced by Best, Inc. during the contract period. The most recent equipment list provided to us by Plant Management for the Capitol Complex cafeterias included no equipment purchased after 1980, the time the contract with Best, Inc. began.

An equipment inventory was taken in March 1986 by Best, Inc. representatives and by a consultant hired by the state. The inventory included all cafeteria equipment. Many items are clearly the property of Best, Inc., e.g. expendable equipment such as silverware, plates, and small hand tools. The larger fixed assets, such as ovens and refrigerators are clearly owned by the state. However, many items have disputed ownership, such as meat slicers, mixers, and other portable equipment. Also, there

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

is no assurance that all items originally provided by the state are still included in the final inventory. Equipment was readily transported between locations and no records were maintained.

The March 1986 inventory noted that many items contained identification stickers of either Best, Inc. or the State of Minnesota. Some items contained stickers from both parties. The stickers are an unreliable indicator of ownership. First, the equipment was controlled by Best, Inc. during the contract term and most likely any new or replacement equipment was assigned a Best, Inc. sticker. Also, the state exerted little effort to ensure that State of Minnesota stickers were retained on its original equipment and properly applied to any new or replacement equipment to which it had ownership rights.

Conclusions on Equipment Ownership

We believe that the state is entitled to the return of an equipment inventory equivalent to what they provided at the origin of the contract, plus any additional items purchased with state funds held by Best, Inc. However, we could only identify documentation which substantiated the items purchased with state funds held by Best, Inc. Neither the state nor Best, Inc. could produce a beginning equipment inventory list that they had agreed upon. The lack of a verified beginning equipment inventory prohibits establishing unequivocal ownership of most equipment items.

Because no records exist to establish equipment ownership, the only means of settlement is through a negotiated process. Unfortunately, it will be impossible to determine whether the settlement is fair and equitable to both parties.

Hopefully, the state now realizes the value of a complete, verified beginning inventory, and good inventory records. These principles should be followed during the new cafeteria contract, so that ownership disputes may be avoided in the future.

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

IV. COMMISSIONS

We attempted to determine whether the state has received all commissions due to them under the terms of the contract. Cafeteria commissions to be paid, as defined by the contract between Best, Inc. (the Vendor) and the state in Schedule B, Part 4, are as follows:

"The Vendor shall make an annual location commission payment to the State. The amount shall be equal to 1 1/2 percent of the annual gross operating revenue. All location commission payments shall be made payable to the State of Minnesota and delivered to the Director of Fiscal Services Division, Department of Administration."

According to the contract, Best, Inc. is allowed "a combined net profit and administrative expense of not to exceed 5 percent of gross cafeteria revenue on an annual basis." Any profits exceeding this 5 percent are also payable to the state, and are referred to as "excess profits." Best, Inc. is responsible for any losses incurred in the operation of the cafeterias.

Our review of commission amounts was limited to financial information provided to Plant Management by Best, Inc. This information included monthly operating statements and location commission reconciliation statements. Even though the financial statements of Best, Inc. are audited in total each year by a private CPA firm, the components relating specifically to the Capitol Complex cafeterias are not individually addressed during that audit. The Department of Administration has only done minimal review of the operating statements provided by Best, Inc. each month. No annual verification of the cafeteria operations was performed by any representative of the state, as required by the contract. Schedule B, Part 22 states:

"The State's representative or his selected auditors will annually, or more often if deemed necessary, examine all financial phases of the operation."

We did not audit the revenues or expenses reported by Best, Inc. relating to the Capitol Complex cafeterias. We did not determine whether sufficient records exist to allow an audit of all prior years' cafeteria activities.

Commission Sources

Table 1 shows the commission amounts as calculated by Best Inc. for the years in which the contract has been in effect. The fiscal year 1986 commission was calculated as of May 3, 1986, based on the last available information at the time of our review. According to Best, Inc. records, total location commissions and excess profits earned by the state during the period November 1, 1980 through May 3, 1986 were \$83,841.74.

TABLE 1
COMMISSIONS
AS CALCULATED BY BEST, INC.

	01-Nov-80 To 27-Jun-81	28-Jun-81 To 26-Jun-82	27-Jun-82 To 25-Jun-83	26-Jun-83 To 30-Jun-84	01-Jul-84 To 29-Jun-85	30-Jun-85 To 03-May-86	Total
Gross Operating Revenue	\$713,971.19	\$940,254.05	\$1,039,632.89	\$1,097,587.54	\$1,085,439.90	\$837,917.33	\$5,714,802.90
Location Commission	\$10,709.57	\$14,103.82	\$9,826.58	\$16,463.81	\$16,281.60	\$12,568.76	\$79,954.14
Excess Profit Commission	0	0	3,887.60	0	0	0	3,887.60
Total Commissions Due To The State	\$10,709.57	\$14,103.82	\$13,714.18	\$16,463.81	\$16,281.60	\$12,568.76	\$83,841.74
Less: Best, Inc. Purchases Charged Against Commissions	0	(9,886.21)	(11,495.16)	(7,253.36)	(5,600.83)	(7,717.39)	(41,952.95)
Amounts with Unknown Disposition	(10,709.57)	(4,217.61)	0	0	0	0	(14,927.18)
Amounts Best, Inc. Admits holding on Behalf of the State	0	0	\$2,219.02	\$9,210.45	\$10,680.77	\$4,851.37	\$26,961.61

DEPARTMENT OF ADMINISTRATION

CAPITOL COMPLEX CAFETERIA CONTRACT

These amounts represent commissions which were due to the state under the contract. Beginning with fiscal year 1983, Plant Management agreed to allow Best, Inc. to retain these commissions and carry them forward within a Best, Inc. account. Best, Inc. was also allowed to disburse amounts from these commissions.

As can be seen from Table 1, only in fiscal year 1983 were any excess profits earned from the cafeteria operation. This excess profit amount was originally calculated to be \$18,378.17. However, this profit was later decreased by \$14,490.57 to \$3,887.60 for depreciation which Best, Inc. claimed they neglected to charge against operations. In a letter to the Department of Administration Fiscal Services Director, Best, Inc. said:

"We provided you with a summary of capital expenditures, which Best Inc. incurred in connection with the operations at the State of Minnesota Capitol Complex cafeterias. Due to our own error, we neglected to depreciate these items into the expenses of the operation as provided under our contract. The total cost of these items, including the finance charges as permitted on the Capitol Cafeteria renovation, was \$27,704.31. The depreciation expense, which should have been charged to the operations from 11/1/80 through 6/25/83 (our most current fiscal year end), amounted to \$14,490.57."

To our knowledge, neither the Department of Administration Fiscal Services nor Plant Management reviewed the documentation supporting this depreciation calculation at the time the depreciation adjustment was made. We did not determine whether this depreciation actually had been omitted in prior years or whether this equipment had been previously included in operating expenses by Best, Inc.

Depreciation is an allowable operating expense according to the cafeteria contract. However, in making this adjustment, Best, Inc. charged two and one-half years of depreciation against fiscal year 1983 excess profits. Excess profits are to be determined annually. In order to correctly present the depreciation expense chargeable to fiscal years 1981 and 1982, the operating expenses for those fiscal years should have been adjusted. Since there was no excess profits in those years, Best, Inc. should have assumed the additional loss resulting from the depreciation in those years. Therefore, rather than the \$14,490.57 depreciation adjustment which was taken against fiscal year 1983 excess profits, only the amount representing depreciation expense for fiscal year 1983 should have been deducted from excess profits for that year.

We reviewed invoices supporting the capital expenditures for which the depreciation adjustment was made and were able to satisfy ourselves that they represented valid Best, Inc. disbursements. However, some of the disbursements, as shown in Table 2, were not actually equipment purchases. Rather, they were supplies which should have been expensed in the year

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

they were purchased and should not have been depreciated. In addition, we found some clerical inaccuracies in the calculation of the depreciation adjustment. Table 2 shows our calculation of the revised fiscal year 1983 depreciation adjustment. Based on our adjustment, we believe that an additional \$9,056.32 in fiscal year 1983 excess profits is owed to the state.

TABLE 2

CALCULATION OF REVISED FISCAL YEAR 1983 DEPRECIATION ADJUSTMENT

Additional equipment to be depreciated per Best, Inc.		\$27,704.31
Less:		
Expendable items not eligible for depreciation:		
Office supplies (invoice dated 10-30-80)	\$ 24.73	
Office supplies (invoice dated 11-11-80)	<u>51.48</u>	76.21
Calculation errors:		
Credit memos received on purchases	\$649.29	
Additional purchase amount to be capitalized	<u>(193.77)</u>	<u>455.52</u>
Revised Additional Equipment to be Depreciated:		<u>\$27,172.58</u>
Best, Inc. calculated depreciation adjustment (for the period 11-1-80 through 6-25-83)		\$14,490.57
Revised calculation of depreciation attributable to fiscal year 1983		<u>5,434.25</u>
ADDITIONAL FISCAL YEAR 1983 EXCESS PROFITS		<u>\$ 9,056.32</u>

For the period January 1 to June 25, 1983, Best, Inc. reduced location commissions from 1.5 percent to 0.5 percent to reflect an increase in sales tax of 1 percent which went into effect at that time. According to the terms of the contract, cafeteria prices could only be changed with the approval of the state. Since cafeteria prices included sales tax, Best, Inc. asked Plant Management to approve a price increase to reflect the additional 1 percent sales tax which Best, Inc. was required to pay as of January 1, 1983. Plant Management refused to grant the price increase, preferring to have Best, Inc. reduce location commissions by 1 percent to cover their increased costs. Location commissions were therefore reduced by \$5,767.91 for that period. We believe that Plant Management should have granted the price increase, and did not have the authority to allow location commissions to be reduced instead. However, because of the close

DEPARTMENT OF ADMINISTRATION

CAPITOL COMPLEX CAFETERIA CONTRACT

relationship between location commissions and excess profits, the reduction of location commissions by \$5,767.91 only served to make fiscal year 1983 excess profits larger by a like amount. Therefore, there is no substantive effect because of the way sales tax was handled during fiscal year 1983.

We conclude that Best, Inc. owes the state an additional \$9,056.32 in commissions for fiscal year 1983. Therefore, commissions earned should have been \$92,898.06 for the period November 1, 1980 through May 3, 1986, rather than the \$83,841.74 reported by Best, Inc. Location commissions for the period May 4 to June 30, 1986, and any fiscal year 1986 excess profits, are yet to be determined.

Commission Uses

We were unable to determine whether the location commissions for fiscal years 1981 and 1982, totalling \$14,927.18, were ever remitted to the state. The Department of Administration Fiscal Services, Plant Management, and Best, Inc. were all unable to provide us with any evidence that these amounts had been paid or otherwise spent. However, both Best, Inc. and Plant Management officials stated that they thought that at least some of this money had been paid to the state. Since 1982, no commission payments have been made to the state. As of May 3, 1986, Best, Inc. admits to owing the state \$26,961.61 in unspent commissions and excess profits.

Since 1982, portions of location commissions have been used by Best, Inc. to purchase items and provide services on behalf of the state. This was agreed to by both Best, Inc. and Plant Management in September, 1982. This agreement was termed to be a contract amendment. However, it did not go through the state approval process required in order for the amendment to be official. We question whether Plant Management had the authority to enter into such an amendment without following required state procedures. The contract amendment states in part:

"Subject to the approval of the State, the Vendor may offset against the Location Commission due the State any amounts due to the Vendor from the State for moneys expended by the Vendor in the operation of the cafeterias in the Capitol Complex which expenditures, under the provisions of the contract, are not obligations of the Vendor."

Plant Management officials have given Best, Inc. approval to make purchases for the cafeterias from location commissions. We believe that Plant Management had no legal authority to spend or to allow Best, Inc. to spend these location commission dollars. According to the contract, the location commissions represent payment for the use of the cafeteria space. Lacking specific budgetary authority for Plant Management to spend these location commissions, the commissions should have been deposited into the state General Fund as non-dedicated revenue. By allowing Best, Inc. to make purchases from location commissions, Plant Management illegally increased their legislative appropriation, as well as circumvented state purchasing procedures.

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

Table 3 details the disbursements and other deductions made from location commissions by Best, Inc. We reviewed the invoices supporting these disbursements provided to us by Best, Inc. They all appear to represent valid disbursements, with the possible exception of a deduction for \$1,500 in fiscal year 1982 for which no supporting documentation could be found.

TABLE 3
LOCATION COMMISSION DISBURSEMENTS MADE BY BEST, INC.

Fiscal Year 1982			
Cleaning Services		\$ 3,295.63	
Renovation of Capitol Cafe:			
Maintenance costs	\$ 145.78		
Shelving	640.55		
Maintenance	55.75		
Repairs, maintenance	45.00		
Repairs, maintenance	56.55		
Maintenance	92.15		
Maintenance	79.25		
Hot food cabinet	1020.87 (1)		
Counter repair and new	997.08		
Cold pan	<u>1333.50</u>	4,466.48	
Equipment for Centennial Ice Cream Parlor:			
Salad bar equipment	162.75		
Unknown	<u>1500.00</u>	1,662.75	
Service on Transportation Cafeteria Equipment:		399.43	
Equipment for Capitol Square Cafeteria:			
Service on equipment	58.80		
Thermometer	<u>3.12</u>	<u>61.92</u>	
TOTAL			\$ 9,886.21
Fiscal Year 1983			
Cleaning Services		\$ 3,072.00	
Dishwasher at Capitol Square		<u>8,423.16</u>	
TOTAL			\$11,495.16
Fiscal Year 1984			
Cleaning Services		\$ 3,180.00	
Trash Containers		1,240.00	
Ice Machine for Centennial Cafeteria		2,165.36	
Cup Dispensers		250.00	
Cafeteria Signs		<u>418.00</u>	
TOTAL			\$ 7,253.36

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

TABLE 3
(con't)

Fiscal Year 1985		
Cleaning Services	\$ 1,680.00	
Cleaning Services Adjustment	(3,660.00)	
Renovation of Transportation Cafeteria (design costs)	7,215.39	
Cup Dispensers	75.00	
Plating of Capitol Cafe freezer shelves	<u>290.44</u>	
TOTAL		\$ 5,600.83
Fiscal Year 1986		
Steam tables for Capitol Square cafeteria	\$ 1,428.00	
Moving Services	3,165.53	
Popcorn Unit for Capitol	371.00	
Ice Machine for Capitol Square with installation	<u>2,752.86</u>	
TOTAL		<u>\$ 7,717.39</u>
GRAND TOTAL		<u>\$41,952.95</u>

(1) The Best, Inc. invoice for the hot food cabinet showed the cost of the item as \$1631.25.

Approvals by the state for some of these disbursements are on file at Plant Management. In some cases, there was correspondence between Best, Inc. and Plant Management concerning specific disbursements. In other cases, we were told that discussions and approvals were handled verbally.

The wording of the contract amendment states that "the Vendor may offset against location commission due to the state expenditures not obligations of the Vendor." Because all of these disbursements were paid from location commission, they must have been considered to be the responsibility of the state. However, according to the contract between Best, Inc. and the state, many of the disbursements made from location commissions were legally the responsibility of the vendor, Best, Inc. and should not have been charged to the state.

In reviewing all of these location commission deductions, we looked for evidence that the disbursement was the responsibility of the state under the terms of the contract. Many of the deductions from location commissions consist of equipment purchases. This includes shelving, a hot food cabinet, cold pan, salad bar, and thermometer totalling \$3,160.79 in fiscal year 1982; ice machine and cup dispensers totalling \$2,415.36 in fiscal year 1984; cup dispensers for \$75.00 in fiscal year 1985; and steam tables, popcorn unit, and ice machine totalling \$4,551.86 in fiscal year 1986. These equipment purchases totalled \$10,203.01.

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

The state was required to provide Best, Inc. with certain equipment at the start of the contract. In regards to this equipment, the contract states in Schedule B, part 1.B.:

"All other equipment that the Vendor deems necessary shall be provided by the Vendor at his own cost and expense. Said equipment and installation must be approved by the State representative."

In addition, the contract states in Schedule B, Part 12:

"In the event the Vendor deems it advantageous to replace any of the existing equipment furnished by the State, he may do so after obtaining written approval from the State. The cost of this new or replacement equipment shall be the Vendor's cost and such costs may be included as an operating expense under the terms of the contract; however, such new or replacement equipment shall become the property of the State."

"It is anticipated that certain items of equipment may be replaced with newer or improved models, or with like equipment more adapted to the operation of the Vendor. This is not to be construed to mean that the State cannot, at its discretion, replace any equipment with like or different equipment at any time it deems in the best interest of the State to do so. It is anticipated, but not required herein, that the State will obtain the concurrence of the Vendor before any major changes of equipment are undertaken."

The financial responsibility for this equipment rests with whomever initiated the purchase. For many of these equipment purchases made from location commissions, it is difficult to determine who initiated the purchase and, therefore, who was financially responsible for it. Accordingly, we could not determine which party was responsible for financing this \$10,203.01 of equipment purchases.

The only other equipment item was a Capitol Square dishwasher replaced in fiscal year 1983 at a cost of \$8,423.16. The cost of this dishwasher was deducted from location commission. The correspondence we reviewed indicated that this dishwasher had been cited as in need of repair at the inception of the contract. As a result, the financial burden for replacing it rested with the state. We therefore believe the \$8,423.16 was a valid deduction from location commission.

Other major disbursements from location commission were for repairs, service, and maintenance on equipment. This includes \$1,929.79 in general repairs, maintenance, and counter repair and replacement in fiscal year 1982 and \$290.44 to plate Capitol Cafe freezer shelves in fiscal year 1985. These repairs and maintenance totalled \$2,220.23.

DEPARTMENT OF ADMINISTRATION

CAPITOL COMPLEX CAFETERIA CONTRACT

According to the contract, these repairs should have been provided by Best, Inc. and not deducted from location commission. Schedule B, Part 1.C. of the contract states:

"It will be the responsibility of the Vendor to maintain and repair all equipment provided hereunder by the State. The Vendor shall also be responsible for the maintenance and repair of the serving counters. The Vendor is required to perform a preventive maintenance program on all State-owned equipment."

In addition, trash containers and cafeteria signs costs deducted from location commissions in fiscal year 1985, totalling \$1,658.00, are both expressly cited in the contract as being the responsibility of the vendor, Best, Inc. As stated previously, there is also an additional \$1,500.00 which was deducted from location commission in fiscal year 1982 but cannot be identified.

We have satisfied ourselves that the remaining location commission deductions were disbursements not the responsibility of Best, Inc., but were made on behalf of the state. They, therefore, were valid deductions from location commissions. Table 4 shows our analysis of the financial responsibility for location commission disbursements.

TABLE 4

FINANCIAL RESPONSIBILITY FOR LOCATION COMMISSION DISBURSEMENTS

	Financial Responsibility of:		
	BEST, INC.	STATE	UNCERTAIN
Equipment	\$ -0-	\$ 8,423.16	\$10,203.01
Maintenance and Repairs	2,220.23	-0-	-0-
Cleaning Services	-0-	7,567.63	-0-
Trash Containers	1,240.00	-0-	-0-
Cafeteria Signs	418.00	-0-	-0-
Renovation	-0-	7,215.39	-0-
Moving Services	-0-	3,165.53	-0-
Unknown	-0-	-0-	1,500.00
TOTALS	<u>\$ 3,878.23</u>	<u>\$26,371.71</u>	<u>\$11,703.01</u>

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

Table 5 summarizes our analysis of location commissions and excess profits over the contract period.

TABLE 5
COMMISSION SUMMARY AS OF MAY 3, 1986

<u>Commission Sources</u>	
Commissions as reported by Best, Inc. (Table 1)	\$ 83,841.74
Fiscal year 1983 commission calculation errors (Table 2)	<u>9,056.32</u>
Total revised commissions earned	<u>\$ 92,898.06</u>
<u>Commission Uses</u>	
Commissions currently held by Best, Inc. (Table 1)	\$ 26,961.61
Fiscal year 1981 & 1982 commissions - status unknown	14,927.18
Fiscal year 1983 depreciation adjustment error (Table 2)	9,056.32
Disbursements on behalf of the state (Table 4):	
Best, Inc. responsibility	\$ 3,878.23
State responsibility	26,371.71
Uncertain responsibility	<u>11,703.01</u>
Total revised commissions used	<u>\$ 92,898.06</u>

Disposition of Commissions Due the State

Best, Inc. agrees that it owes the state \$26,961.61 as of May 3, 1986. Also, there is no dispute that location commissions from May 4, 1986 through June 30, 1986, plus any excess profits for fiscal year 1986, are owed to the state. We believe that Best, Inc. owes the state an additional \$12,934.55. This additional liability is comprised of \$9,056.32 for the depreciation adjustment error in fiscal year 1983, and \$3,878.23 for location commission funds spent on items for which Best, Inc. was financially responsible. Thus, we believe Best, Inc. owes the state a minimum of \$39,896.16 as of May 3, 1986.

The status of an additional \$26,630.19 remains uncertain. First, there is the \$14,927.18 of fiscal year 1981 and 1982 location commissions which is unaccounted for. Both parties believe that some or all of those funds were paid to the state several years ago. However, no evidence of any payment has been found yet. Another \$10,203.01 subject to uncertainty concerns the majority of the equipment purchased with state location commissions held by Best, Inc. Because we could not establish which party originated these purchases, we cannot determine who bears the financial responsibility. As discussed in the previous section, the state retains ownership rights for this equipment. However, as we indicated, ownership

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

rights are not necessarily related to financial responsibilities, especially with replacement items for the original state equipment inventory. The final \$1,500 was expended from location commissions but its purpose could not be established. The absence of reliable documentation may necessitate negotiating the final disposition of the \$26,630.19.

The final \$26,371.71 of commissions represent amounts which were spent by Best, Inc. on the state's behalf and which we believe were the financial responsibility of the state pursuant to the contract. Although we doubt the legality of this practice, we believe that Best, Inc. cannot be expected to repay this amount. Best, Inc. was acting on good faith and dealing with the proper state representative. They did not benefit from these purchases. From their standpoint, it made no difference whether they paid the state this money or spent it on the state's behalf. We believe the only possible recourse, concerning these unauthorized expenditures, would be with the responsible officials from the state Department of Administration.

Best, Inc. has argued that they should only have to repay the \$26,961.61 which they claim as owing on May 3, 1986. They argue that the state representative approved many of the financial transactions and was notified of all transactions. Also, specifically on the fiscal year 1983 errors, they argue that Administration had this information available to them for several years and sought no adjustment to the Best, Inc. calculations. In general, they argue that they should avoid further liability because they were dealing with the state representative in good faith. We reject these arguments because we feel that, in several cases, Best, Inc. has been unjustly enriched and received benefits to which they were not entitled pursuant to the contract.

Because of the problems we have identified and the uncertainty regarding payment of the proper commission amounts, we are referring this report to the Attorney General pursuant to Minn. Stat. Section 3.975 for any appropriate action.

DEPARTMENT OF ADMINISTRATION
CAPITOL COMPLEX CAFETERIA CONTRACT

V. CONCLUSIONS

We believe that the Department of Administration has been negligent in several aspects of administering the cafeteria contract with Best, Inc. At the inception of the contract, several key control provisions were ignored. No beginning equipment inventory was taken and/or recorded. Also, the condition of the original equipment was never assessed and agreed upon by the two parties. These actions were vital to establishing equipment ownership and certain financial responsibilities. Their absence was translated into the uncertainties discussed in Sections III and IV.

Certain important financial controls were also disregarded during the contract term. Equipment purchases, dispositions, replacements, and transfers were never recorded. Thus, the beginning equipment inventory could not even be reconstructed. Also, the financial statements provided by Best, Inc. were never verified for accuracy. State location commissions were based wholly upon gross operating revenues reported by Best, Inc. However, the reported revenues were never tested or challenged. The state was risking underpayment of location commissions by not verifying the revenues reported. Also, expenses reported by Best, Inc. could have been overstated which would potentially deprive the state of any excess profits to which it was entitled. Best, Inc. was audited by a CPA firm, but the audit focused on their consolidated financial activities and offered no assurance that the reported financial activities of the five Capitol cafeterias were accurate. The Department of Administration staff conducted only a cursory review of the financial statements submitted by Best, Inc. We found no evidence that their limited review served any effective role.

Finally, we believe that Administration officials exceeded their authority on at least two occasions and agreed to permit Best, Inc. to undertake certain activities which were not allowed by the contract. The actions for which we believe they lacked authority, were:

- Permitting Best, Inc. to reduce location commissions in 1983, because of an increase in the state sales tax. Best, Inc. alleges that they attempted to seek a price increase in 1983 because of the increased sales tax rate. However, they indicated that Administration officials denied a price increase in mid-year and agreed rather to accept a reduced location commission amount. The contract did not allow for this action. Also, such an action would have required approval through the formal state contract amendment process, if it were to have been proper. However, we doubt that this substitution would have survived the formal amendment process. The effect of this action was having the state General Fund (the intended beneficiary of the location commissions) subsidize the Capitol cafeteria customers (those intended to pay any price increase associated with the sales tax increase).

DEPARTMENT OF ADMINISTRATION

CAPITOL COMPLEX CAFETERIA CONTRACT

- Directing Best, Inc. to retain the commissions it owed the state and to spend these funds on the Capitol cafeterias. Pursuant to state law, the commissions were to have been deposited as non-dedicated revenues in the state General Fund. Only a legally authorized appropriation could have permitted the use of state funds on the Capitol cafeterias. Hence, this action constitutes a misappropriation of state funds and circumvents the proper processes for approving state spending and purchasing. In addition, there are various fiscal disadvantages of this practice. The state foregoes any investment income it could earn on the commissions and likewise allowed Best, Inc. to benefit from the time value of money. Also, Best, Inc. would have to pay sales tax on its purchases, while the state is exempt from sales tax. Obviously, the practice should have been avoided.

As a result of the many problems with this contract, the process of establishing equipment ownership and settling financial responsibilities will be very difficult. The only means of reaching an agreement upon the contract termination is through a negotiated settlement. No records or evidence exist to ensure that the settlement will be fair and equitable for both parties.

FUTURE CAFETERIA CONTRACTS

We are concerned that the new cafeteria contract be written and administered in a manner which will avoid many of the problems cited in this report. Specifically, we believe that:

- A reliable beginning state equipment inventory must be established and then maintained throughout the contract term. Up-to-date inventory records should be maintained regarding all equipment purchases, disposals, replacements, modifications, and transfers. The state should periodically verify the physical existence and condition of its equipment by periodic inventory counts and reconciliations.
- The state should promptly collect all commission amounts due from the vendor. The vendor should not be allowed to hold or spend commissions which are due to the state. Also, the state should deposit the commissions into the proper state account and comply with all applicable state laws, processes, and regulations regarding the use of the funds.
- The state should institute requirements and/or procedures which will enhance the reliability of the financial information provided by the vendor. Ideally, the vendor would have a separate financial audit performed on its Capitol cafeteria operations.

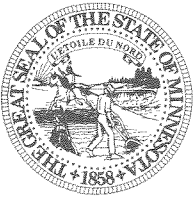
DEPARTMENT OF ADMINISTRATION

CAPITOL COMPLEX CAFETERIA CONTRACT

In addition, the state may want to periodically conduct a review of the vendor's books and challenge the validity of any questionable financial information.

- The state must adhere to the contract terms and enforce all applicable provisions on the vendor. If the contract appears to require modification, then the formal state contract procedures must be followed in seeking any amendments.

The establishment of these procedures should ensure that future cafeteria contracts are administered more successfully.



**Department of
Administration**

July 16, 1986

**OFFICE OF
THE COMMISSIONER**

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Telecommunications
Volunteer Services

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Veterans Service Building
St. Paul, Minnesota 55155

Dear Mr. Nobles:

This letter is in response to your letter of June 27, 1986 and the attached copy of the special review of the state contract with Best, Inc., the Capitol Complex food vendor for the last 5½ years. The audit study and the report were the result of a request from the Plant Management Division of the Department of Administration. The request was made on April 14, 1986.

Thank you for the report. We are pleased to receive it, since it supports the steps we have already taken to remedy previously existing unsatisfactory situations. In fact, one reason the Request for Proposal (RFP) was rewritten and redesigned was to address some of the same problems and concerns more recently raised in your report. The RFP was originally issued in August of 1985 and withdrawn in September of 1985. It was reissued in February 1986 after being extensively revised.

Indeed about a year ago as department staff began preparing to advertise for proposals for the food service, we concluded that the form and language used in 1980 and previously, needed improvement; and that the state could benefit by the advice of a professional food service consultant. Further, we recognized that specific steps should be taken to involve food service customers in the vendor selection process.

The RFP, revised and rewritten with the input and assistance of Paul J. Cleary, a professional food

James R. Nobles
Page 2
July 16, 1986

service consultant, serves essentially as the new contract language. We believe it to be a very significant improvement over the previous contract.

Funds Due The State

The report's findings as to specific amounts of money, which may be due the state, whether from location commissions or excess profits, are being examined. The department will take whatever actions are necessary to assure that all monies due the state under the terms of the previous contract will be collected. (Subsequent to receiving your report, the location commission payment records for 1981 and 1982 referenced on page 11 of the report have been located. Two checks totaling the amount of \$14,927.18 as listed in the report on page 11 and 16 were received and deposited in November 1981 and October 1982 respectively).

Equipment

We agree with your conclusion that it will be necessary to use negotiation (p.6) to resolve certain equipment disputes in the absence of adequate ownership records and such negotiation is under way.

Equipment inventory records to avoid future problems are being put in place and will be regularly maintained.

Since the new contract requires that the state purchase and own the equipment, the possibility of similar problems in the future has been minimized.

Commissions

Commission payments henceforth will be paid monthly and the Fiscal Services Division of DOA will maintain a separate account to record such payments. The Fiscal Services Division will be responsible for receiving such payments and depositing them in the Internal Service Fund account established by the 1985 Legislature for operation of the Plant Management activities.

James R. Nobles
Page 3
July 16, 1986

As noted in my opening response, the DOA will take appropriate actions to assure that the state receives payments from either location commissions or excess profits due under the previous contract.

Your report indicates that you do not believe that the September 1982 contract amendment was official since it "...did not go through the state approved process required...."

This amendment allowed the vendor to withhold payment of location commissions and, with the approval of the state, to use those monies in the operation of the Capitol Complex Cafeterias for items which were not the contractual responsibility of the vendor.

In my judgment, this amendment was a practical, good faith effort by my predecessor to achieve a mutually desired end result. It was done openly and you have examined the disbursements and other deductions made under its terms. You conclude that with the exception of a \$1,500 transaction in 1982 for which you can't identify the items, the balance of the nearly \$42,000 expended "represent valid disbursements,..." (p.12).

Further, there appears to have been earlier precedent for such contract language. For example, a May 16, 1974, amendment to the June 1973 contract between the then vendor (Canteen Corp.) and the state allowed for funds "...to be kept in escrow for the vendor from which the state can approve the purchase of equipment or undertake remodeling improvements to the Cafeteria." This earlier contract amendment which was signed by an Assistant Commissioner of Administration and a Special Assistant Attorney General, probably served as precedent for the 1982 amendment.

In light of these facts, I do not agree with your conclusion that Plant Management acted illegally.

However, since you indicate the report will be referred to the Attorney General because of this and other problems, I have taken the liberty of

James R. Nobles
Page 4
July 16, 1986

sharing the draft report with one of the Special Assistant Attorney Generals who provides legal service to the Department of Administration. The Attorney General's Office has assisted in developing the new contract and has advised us on these and other contractual matters.

Furthur Auditing of Previous Contract

Following the exit conference on June 23, 1986 and the receipt of the draft report, we have discussed whether further auditing is necessary. At the exit conference you indicated that the issue to determine was whether additional audit work would be cost effective. Even though we are still negotiating with Best, Inc. to resolve the equipment and other issues and we have not seen their response to the draft audit report, we do not believe it would be cost effective to spend several thousand dollars at this time on additional audit work.

Future Audits

Future audits will be done at least annually as called for in the contract. Such audits will review that part of the current contractor's activities, fiscal and operations, that are related specifically to their Capitol Complex food services.

Conclusions

Needless to say, I am disconcerted by so many instances of inadequate contract administration and fiscal accounting procedures which have occurred in the past in regard to the Capitol Complex Food Service.

While it is accurate to point out that budget cutbacks since 1981 have stretched our professional staff too thin to perform the essential administrative and managerial tasks expected or required, I do not offer that as an excuse for the inadequate contract oversight at issue. In fact, earlier this year, because of our concern, we assigned an administrative expert from our Real

James R. Nobles
Page 5
July 16, 1986

Estate Management Division to work with Plant Management on several special projects. The food service contract was and is his top priority.

Since the report questions the legality or "official" status of certain transactions, it seems only appropriate to note that nowhere is there any suggestion of personal gain or impropriety on the part of past or present DOA officials or employees.

This response is sometimes general for at least the following reasons: 1) The complexity of the issue. 2) The fact that some of the persons knowledgeable about and involved in past practices regarding the food service contract history are no longer with the department. Some have retired or moved to other employment and thus are not in a position to provide specific details, at least not on short notice. 3) Since your recommendation for resolution of both equipment and financial issues is a negotiated settlement, and since we are still working on that negotiation, it would be counterproductive to go into details of how specific subjects might be negotiated.

Finally, I am confident that with the new contract, increased staff attention and ongoing review of policies and procedures, the state will not have a repeat of the unsatisfactory situations cited in your report.

The recommendation at the end of the report labeled "Future Cafeteria Contracts" are consistent with and supportive of the changes we anticipated and incorporated in the RFP and resulting contract developed early this year. They will be implemented. In addition to the earlier referenced equipment negotiation, your conclusion that a "negotiated settlement..." is the only way to reach agreement on equipment ownership and financial responsibilities will be implemented.

(p.19). If you have additional specific recommendations for either the fiscal or operational aspects of the new contract, I would be glad to receive them.

James R. Nobles
Page 6
July 16, 1986

Thank you for the opportunity to include this
response with your report.

Sincerely,

A handwritten signature in cursive script that reads "Sandra J. Hale". The signature is written in dark ink and is positioned above the printed name and title.

Sandra J. Hale
Commissioner

SJH:JLP:nb

"We are BEST"

Best, Inc., 563 Payne Avenue, St. Paul, Minnesota 55101 Telephone: 612/778-8829

July 14, 1986

Mr. John Asmussen
Deputy Legislative Auditor
Veterans Service Building
St. Paul, MN 55155

We are in receipt of the draft copy of your Special Review Report on the State contract with Best, Inc. We appreciate the opportunity to provide a formal written response to your comments and conclusions. In response we offer the following comments:

I.

Calculation of Revised Fiscal Year 1983 Depreciation Adjustment (Table 2)

Best, Inc. realized at the end of fiscal year 1983 there may be adjustments necessary in recording depreciation for certain equipment purchased for use at the capitol complex cafeterias. Best, Inc. notified the state of this possibility shortly after the end of the fiscal year. Upon final determination of the amount of the adjustment, (which was determined in connection with an independent audit of our financial records) Best, Inc. promptly notified the State. This notification was done in writing and at a formal conference among the State's representatives: James Ware, Director of Plant Management, Don Klein, Manager of Fiscal Services, and Best Inc.'s representatives: Perry Rynders, C.P.A., Vice President/Finance, and William Trieber, General Manager. The State's representative was consulted in this matter because there was a question of how to treat the adjustment for accounting purposes and the Contract with the State provided in Schedule B, Section 13 that the accounting books and records shall be maintained in a manner satisfactory to the State's representative. Further, Section II of Schedule B provided "the decisions of the State's representative relative to the proper performance of the terms of the Contract shall be final and conclusive on the parties hereto. It was agreed by all present that the treatment of the adjustment was acceptable and this was subsequently confirmed in writing with the State's representative.

The items of office supplies referred to in Table 2 totaling \$76.21 were improperly capitalized. It should be noted however that these items were insignificant and were parts of larger invoices of which all other items were properly capitalizable. In addition, these items, at the time of discovery had not been expensed to the operating statements, consequently the effect of Best, Inc.'s treatment of these items was merely to expense these items over a 5 year period of time as opposed to all within one operating period. If an adjustment is made to remove these items from the depreciation schedule another adjustment should be made to expense them.

The calculation errors with respect to the credit memos and additional purchases primarily involve credits for defective merchandise and subsequent replacement thereof. It is likely that all of the defective items for which the credit memos were issued were ultimately replaced thereby eliminating the need for this adjustment.

Table 2 also reflects the depreciation adjustment made to the fiscal year 1983 operating statements. Best, Inc. had a financial audit performed by an independent certified public accounting firm shortly after the end of fiscal year 1983. As part of this complete audit, the amount of this adjustment was determined in its cumulative effect through the end of the latest fiscal year end which was June, 1983. Since the financial records (i.e. "books") for fiscal years ending June, 1981 and June, 1982 were already closed, but the financial records for June, 1983 had not been closed, these records were adjusted accordingly. As indicated previously this treatment was presented in December, 1983 to the State's representative pursuant to Schedule B, Sections 11 and 13 of the Contract and the adjustment treatment was approved as appropriate and acceptable and has not been questioned since. Consequently, Best Inc. believes this adjustment was properly treated and approved and Best does not have liability for additional excess profits for the year ended June, 1983.

Additional considerations also come to bear with this issue. The Contract stated in Schedule B, Part 21:

"The Vendor shall maintain his menu pricing structure in such a manner so as to result in a combined net profit and administrative expense of not to exceed 7% of gross cafeteria revenue from the operation on an annual basis".

and Schedule B, part 22:

"The State's representative or his selected auditors will annually, or more often if deemed necessary, examine all financial phases of the operation. Periodic reviews, conducted jointly by representatives of the Vendor and the State will be made to insure that the staffing pattern, menu pricing structure and other phases of the operation are

conducted in the most efficient basis. The purpose of the review is to assure that the Vendor does not realize an excessive net profit and that State employees are provided with quality, convenient food service, under sanitary and healthful conditions, at the most reasonable prices possible. It is the intent of this contract that any excess of allowable profit or administrative expense be reflected in lower food cost to patrons. If, however, at the Vendor's annual audit or termination of the contract, the audit shows that the 7% combined net profit and administrative expense is exceeded, such excess shall be payable to the State".

Two points are important in this part of the Contract:

1) That the intent of the state was the Vendor receive fair and reasonable compensation for its services and that the food service patrons pay a reasonable price for the products. Consequently, had the increased depreciation amounts been recorded during fiscal years 1981 and 1982, they would have resulted in price increases to maintain the pricing structure noted above as required under the contract. I.E. had food service costs for the fiscal year ended June, 1982 been anticipated to be \$5,434.25 higher (as indicated in the auditors report) prices would have been increased to recover these higher costs as indicated above. In effect, although indirectly, the excess profits for fiscal 1983 alleged in the auditors report, resulted in lower food costs to the patrons in 1981 and 1982. Therefore, it appears that the state's objectives, that the vendor receive reasonable but not excessive compensation and that the State's employees pay reasonable prices, were achieved through the treatment of this adjustment.

2) The Contract describes the measurement date for excess profits to be at the time of the annual audit or termination of the contract. Since the auditors report acknowledges that no annual audits were ever performed, the determination of excess profits is made at the termination of contract. Since the cumulative combined net profit and administrative expense for the life of the contract is considerably less than 5% of sales, there is no excess profit for the determination period, the contract term.

II.

Financial Responsibility for Location Commission Disbursements (Table 4)

The audit report states the following:

1) The financial responsibility for purchases of equipment out of location commission funds amounting to \$10,203.01 is uncertain.

It is the auditor's opinion that "the financial responsibility for this equipment rests with whomever initiated the purchase. However, the contract clauses cited in the auditor's report provide that the state, at its discretion, may purchase any equipment it deems in the best interests of the state to purchase. In the case of each purchase in question, Best, Inc. obtained the prior approval and direction of the State's representative to disburse the location commission funds for the purchase of the equipment. None of the equipment purchases would have been made had the State's representative not given his direction to purchase the equipment using the location commission. Best, Inc. acted solely in reliance on the agreement and instruction of the State's representative who by definition in the Contract, "in all things concerning this Agreement, represents the State and makes all related decisions". To now allow the State to deny responsibility for purchases it be made from location commissions and to charge Best, Inc. for the cost thereof is in the least inequitable. Consequently, as these were purchases of equipment which the State deemed in its best interests to make from location commissions the purchases should remain as the financial responsibility of the State. Keep in mind that if the State's representative had not previously requested the purchases be made from the location commissions he most certainly would have raised an objection at the time he received the periodic or annual location commission reconciliation, not years after fact.

2) The maintenance and repair costs of \$2,220.23 paid with disbursements from location commission funds were the responsibility of Best, Inc.

These disbursements were made for the following reason: At the beginning of the Contract, certain equipment provided by the State was not in good working order. As indicated in the auditor's report, the Contract called for the vendor and the State to inspect the equipment at the start of the contract and in the event there was agreement that repairs were necessary, the State and vendor were to negotiate an agreement for repair or replacement of such equipment and the method of payment therefore. Although there is no written documentation to indicate that such inspection was made, Best ultimately negotiated an agreement with the State's representative for the repair of equipment initially provided by the State. The costs of these repairs were paid at least in part with location commission funds per the direction of the State's representative. Again, it should be noted, Best only disbursed location commission funds upon the direction of the State's representative and always provided the State with a prompt written summary of all disbursements made. Consequently these disbursements were the financial responsibility of the State, not Best, Inc.

3) The cost of the trash containers in the amount of \$1,240.00 paid with disbursements of location commission funds was the financial responsibility of Best, Inc.

It should be noted that these trash containers are not actually "trash cans" but are actually trash can envelopes. They are relatively large wooden structures, each costing \$640.00, which were placed in the dining room areas of the Department of Transportation building. They were purchased so that the actual trash cans could be placed inside, fully enclosed, and consequently the trash cans would be out of sight of the patrons. These items are clearly not the same items referred to in the Contract as "trash and refuse containers", they are more clearly akin to dining room decor equipment. Again, since this purchase was based on the prior direction to disburse location commission funds was made by the State's representative, the cost of this purchase is the financial responsibility of the State.

4) The cost of the cafeteria signs in the amount of \$418.00 paid with disbursement of location commission funds was the responsibility of Best, Inc.

Once again, it appears there is a misunderstanding with respect to terminology. The section of the Contract which the auditor apparently is referring to, states as follows:

The Vendor shall provide menu boards in conspicuous places, so that they may be observed while approaching each serving line. These signs shall list the items of food and their prices. The size of the signs, the size of the lettering, the location of the signs and the physical quality of the sign itself, including type, style, design and appearance, shall be subject to the approval of the State. No signs shall be posted anywhere in the cafeteria area except with the approval of the State.

The signs which were purchased with location commission funds are wooden decorative signs which are directional in function. They are currently in use at the Department of Transportation to indicate to patrons which section of the serving line has eatrees, grill orders, sandwiches, etc. None of these signs are menu boards. These are again equipment items purchased with funds on the direction of the State's representative and should remain the financial responsibility of the State.

5) The financial responsibility for the disbursement of location commission funds made in the amount of \$1,500 in fiscal year 1982 is uncertain.

This disbursement was made payable to and was endorsed by an individual. It was paid in connection with the renovation of the Centennial Building Ice Cream Parlor. Best, Inc. has been unable at this late date to locate an invoice supporting this purchase. However, a copy of the check as well as a schedule listing this disbursement was provided to the State's representative shortly after the disbursement was made. Consequently, this appears to be an isolated instance for which a supporting document can not

be located four years later, but represents a valid and legitimate disbursement of location commission funds and should remain as the financial responsibility of the State.

A very important issue needs to be raised here with respect to the disbursement of location commission funds. In no instance did Best, Inc. disburse location commission funds without prior direction from the State's representative. In addition, Best, Inc. provided the State complete periodic schedules, summaries, and reconciliations of all location commission funds as well as additions to, disbursements from, and adjustments to the funds. These schedules, along with supporting documentation were provided to both the Department of Plant Management and the Department of Fiscal Services as frequently as every four weeks, and never less frequently than annually. Since Schedule B, Part 2 Definition of Terms states:

"Wherever and whenever the following words or their pronouns occur in the contract documents, they shall have the meaning given here:

"State": The State of Minnesota, acting by and through its Commissioner of Administration and his authorized and designated representative.

"Representative of the State" or "State's Representative":

The single person officially designated by the Commissioner of Administration, who in all things concerning this Agreement, represents the State and makes all related decisions".

and Section B, Part 11 Right to Decide Questions states:

"The decisions of the State's representative relative to the proper performance of the terms of the Contract shall be final and conclusive on the parties hereto, and shall be final and conclusive as to each matter not covered in the Contract and Specifications that may arise in connection with the privileges granted, and also as to each matter which is not clearly covered herein."

The state in its Contract expressly gave authority to its representative to act on behalf of and bind the State. Based on this authority it was reasonable for Best, Inc. to rely on the direction and approval by the State's representative to disburse location commission funds for various items as the final and authoritative decision of the State. It would be unfair for the State to retroactively retract that authority which Best reasonably relied on and to transfer financial responsibility for obligations knowingly and freely requested and accepted by the State to Best, Inc. Best, Inc. was not unjustly enriched by the

purchases made from location commissions but it would be unjustly penalized for relying on the express authority granted by the State to its representative.

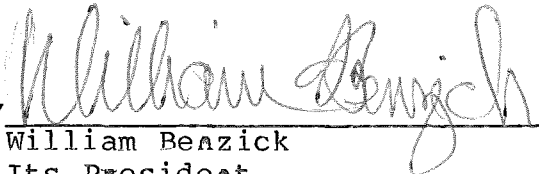
The timeliness of this dispute is also important. Section B, Part 2 of the Contract allows the vendor only 30 days from the date of a dispute in which to file a claim with the state. Of course contractual provisions regarding time limitations for making claims should be reciprocal. For most of the items questioned in the auditors report, it has been at least two years and in some cases more than five years since the disbursements were approved by the State, paid to the supplier and subsequently reported on periodic or annual schedules and summaries. The reasons for setting a time for making claims to first provide notice to a party that an action taken is being questioned, second to allow for a determination of what is the proper procedure, so that third, the determination made can be used as a guide for the parties' future actions. If the State's position was going to be other than that asserted by its designated representative, then that position should have been made known in the first year of the Contract so the vendor would know not to rely on the determinations of the State's representative for future actions. If disbursements were disallowed and timely notice thereof given in 1981, Best, Inc. would not have relied on the State's representative's approval to make similar disbursements in 1982, 1983, 1984, 1985 or 1986. As periodic detailed reports and reconciliations were provided setting forth in detail all matters now being questioned by the State (for the first time), Best, Inc. was not acting without the knowledge of the State. It has been detrimental to Best, Inc. for the State to wait so long to raise its claims.

Finally, with respect to the location commission balances payable for fiscal years 1981 and 1982 in the amounts of \$10,709.57 and \$4,217.61 respectively, evidence in the form of cancelled checks has been located which show these balances have been paid by Best, Inc. to the State. Copies of the following cancelled checks are attached hereto:

Check					
No.	Payor	Payee	Date	Amount	Endorser
14089	Best Inc.	State Treasurer	11/12/81	\$10,709.57	State of MN Dept. of Admin. Fiscal Services
15206	Best Inc.	State of MN	11/21/82	\$ 4,217.61	State of MN Dept. of Admin. Fiscal Services

This response is respectfully submitted by:

BEST, INC.

By 
William Benzick
Its President

WB/cd

BFS

BEST FOOD SERVICES, INC.
FOOD SERVICE MANAGERS-VENDING
117 STATE STREET ST. PAUL, MINNESOTA 55107

14089

November 12 19 81 ²²⁻⁷₉₈₀

PAY TO THE
ORDER OF State Treasurer

\$10,709.57

REG. 8U403147 **10709574**
EXP. 11-7-83

DOLLARS



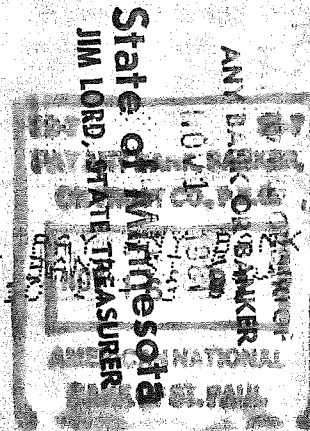
American Bank

American National Bank and Trust Company
Fifth & Minnesota St. St. Paul, Minn. 55101

0950-0001-4

James Schermer
53542-72 X101

INCLUDE CHECK PRINTERS - YES



PAY TO THE ORDER OF
STATE TREASURER
JIM LORD
State of Minnesota
Department of Administration
Food Services
CI

BFS

BEST FOOD SERVICES, INC.
FOOD SERVICE MANAGERS-VENDING
563 PAYNE AVENUE ST. PAUL, MINNESOTA 55101

15206

PAY
TO THE
ORDER OF

7 6 0 0 1 2 1 7 6 8 7 Oct 21 1982 ²²⁻⁷/₉₆₀
State of Minnesota

\$4217 ⁶¹/₁₀₀

REG. BU403146

EXP. 11-7-88

4217.61

DOLLARS

AMERICAN
NATIONAL BANK • SAINT PAUL
American National Bank and Trust Company
Fifth and Minnesota Streets • St. Paul, MN 55101

W. J. Scherer
X101

DELUXE CHECK PRINTERS - YES

FIRST
1409 26

State of Minnesota
TREASURER

OCT 26 1982

TO THE ORDER OF
ANY BANK OR BANKER

214091608